No. 708

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

CREDIT ALLIANCE CORPORATION

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13-24) is reported at 42 B. T. A. 1020. The opinion of the Circuit Court of Appeals (R. 32-38) is reported at 122 F. (2d) 361.

JURISDICTION

The jurisdiction of this Court has been invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Is a dividends paid credit allowable under Section 27 (f) of the Revenue Act of 1936 for earnings and profits distributed to a parent corporation in complete liquidation under Section 112 (b) (6) of that Act which provides that no gain or loss shall be recognized on receipt of the distribution?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in Appendix A, *infra*, pp. 38-52.

STATEMENT

The facts as stipulated (R. 10-13) were found by the Board of Tax Appeals (R. 14) and may be summarized[1] as follows:

Respondent, Credit Alliance Corporation, was organized in 1922, under the laws of New York, and dissolved in July of 1937 (R. 10). During its corporate existence respondent was actively engaged in business. In 1930 the Commercial Credit Company, a Delaware corporation, acquired more than 80 per cent of respondent's outstanding capital stock and by December 1, 1936, it owned 526,238 shares out of 528,186 shares outstanding (99.63 per cent) (R. 11). Its holding continued the same until cancellation of all stock, which took place beginning in 1936. In that year liquidation of respondent was decided upon, in order to simplify the corporate structure, and on December 1, 1936, the stock-

[1] We summarize the facts as stipulated because the Commissioner has used the "Statement" to argue his case. See Commissioner's Brief, pp. 3, 4, 5.

holders and directors of respondent, by appropriate action, resolved to liquidate the corporation completely within three years, to distribute in liquidation property equivalent to $1.80 per share, to reduce the stated value of stock from $8.00 to $1.00 per share on December 10, 1936, by a reduction of capital and to distribute $7.00 per share in liquidation on that date to the stockholders of record as of December 3, 1936 (R. 11).

In accordance with the plan of complete liquidation, respondent distributed in 1936, out of earnings and profits, cash and property of a stipulated value of $950,734.80 (R. 11). Respondent's parent, Commercial Credit Company, received $947,228.40 and respondent's remaining shareholders received $3,506.40. In 1936 respondent also distributed to its stockholders $3,697,202.00 by reduction of capital as aforementioned. Further distributions were made in 1937 and the liquidation was completed in 1938. Pursuant to Section 112 (b) (6) of the Revenue Act of 1936 no gain or loss was recognized to Commercial Credit on this liquidation (R. 12).

Admittedly (R. 11), the $950,734.80 was in fact distributed in liquidation out of "earnings and profits accumulated after February 28, 1913" and in its income tax return for 1936 respondent claimed a dividends paid credit under Sections 14 and 27 of the Revenue Act of 1936 for the full amount of that liquidation distribution (R. 41). The Commissioner, petitioner here, allowed the credit to the extent of the amount distributed to minority stockholders, but disallowed it to the extent of $947,228.40, the amount distributed to the parent company. This resulted in the determination of a deficiency of $121,814.49 in respondent's undistributed profits tax for 1936 (R. 5).

Respondent filed a petition for redetermination (R. 2) and the Board of Tax Appeals (after consideration by the full Board) held that there was no deficiency (R. 13). The Commissioner filed a petition for review, and the Circuit Court of Appeals for the Fourth Circuit, in a unanimous decision, affirmed the decision of the Board of Tax Appeals (R. 32). Shortly thereafter, the Circuit Court of Appeals for the Second Circuit, again unanimously, reached the same decision on the same question in another case. *Commissioner* v. *Kay Manufacturing Corp.*, 122 F. (2d) 443.

The Commissioner sought certiorari, claiming a conflict between the decision below and *Centennial Oil Co.* v. *Thomas*, 109 F. (2d) 359 (C. C. A. 5), certiorari denied 309 U. S. 690. Respondent did not oppose the Commissioner's petition because admittedly there was a conflict between the decision by the Fifth Circuit and the decisions by the Second and Fourth Circuits on the question whether Section 27 (h) denied the credit allowed by Section 27 (f).

ARGUMENT

Setting of the Case

In this case the Commissioner claims an "undistributed profits surtax" is owing upon the 1936 earnings of Credit Alliance, even though it is admitted as a fact that Credit Alliance, in 1936, distributed to its stockholders in complete liquidation, in addition to capital, earnings accumulated since February 28, 1913 in an amount in excess of its adjusted net income for 1936.

This case is concerned with only one of the tax consequences of the distribution of earnings by a subsidiary (Credit Alliance) to its parent (Commercial Credit)

in a complete liquidation. There is no dispute here as to the effect of the distribution on the parent, since by reason of Section 112 (b) (6) of the Revenue Act of 1936 no gain or loss was recognized to the parent as a result of the liquidation of the subsidiary. Nor is there any dispute here as to the liability of respondent or its parent for ordinary income taxes which each paid in very substantial amounts for the year 1936. The only issue here is whether Credit Alliance should have paid an undistributed profits surtax for 1936 even though its earnings were in fact distributed during that year.

The undistributed profits surtax appeared for the first time in the Revenue Act of 1936.[2] Section 14 (b) of that Act imposes a surtax at graduated rates upon the undistributed profits of corporations. The tax is computed upon such portions of "undistributed net income" as are in excess of specified percentages of "adjusted net income".

The term "adjusted net income" is defined as net income less normal income tax and certain specified credits. The term "undistributed net income" is defined as "the adjusted net income minus the sum of the dividends paid credit provided in Section 27", and another credit which is of no importance in this case.

Whether Credit Alliance should have paid an undistributed profits surtax, as the Commissioner is claiming, depends upon whether it was entitled to a "dividends paid credit" under Section 27 of the 1936 Act because it distributed its earnings and profits in liquidation. That is the narrow question in this case.

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[2] The surtax because of undistributed profits disappeared completely in the Revenue Act of 1938. Undistributed profits were considered only for the purpose of determining whether a small credit, in no event to exceed 2½%, should be allowed against the ordinary income tax.

If the "dividends paid credit" of Credit Alliance equals or exceeds its "adjusted net income", Credit Alliance is not liable for an undistributed profits tax. Section 27 (f) of the 1936 Act grants a "dividends paid credit" where (a) there are "amounts distributed in liquidation" and (b) the amounts are "properly chargeable to the earnings or profits accumulated after February 28, 1913". The Section specifically provides that distributions possessing these two characteristics shall "for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid".

It is admitted that in fact Credit Alliance distributed the amount of $950,734.80 in liquidation and it is further admitted that this amount was distributed out of earnings and profits accumulated since February 28, 1913, and it is also admitted that the adjusted net income of Credit Alliance for the year 1936 was less than $950,734.80 (R. 7, 11). Notwithstanding these undisputed facts, the Commissioner contends that Credit Alliance is not entitled to a dividends paid credit in the amount of $950,734.80 because he says that even though Section 27 (f) provides that a liquidation distribution shall "be treated as a taxable dividend paid", it cannot be treated as a taxable dividend paid unless it is in fact taxable in the hands of the recipient.

I

Section 27 (f) Requires the Allowance of the Credit

If the language of Section 27 of the Revenue Act of 1936 is given its plain and ordinary meaning, Credit Alliance is entitled to a dividends paid credit in the sum of $950,734.80 and is therefore not liable for an

undistributed profits surtax for the year 1936. Recognition of the plain and ordinary meaning of the language gives to each of the subsections of Section 27 a rational meaning and function and, as it will appear, is thoroughly consistent with the purpose of the undistributed profits tax law.

In support of our argument, we shall first examine the pertinent sections of the law—with particular emphasis upon Section 27 (f), which deals with distributions in liquidation—and we shall then show that the $950,734.80 distribution complies with each and every requirement necessary to qualify it as a dividends paid credit.

A. Pertinent Subsections of Section 27

Section 27 (a)[3] of the Revenue Act of 1936 defines the dividends paid credit as "the amount of dividends paid during the taxable year". Section 27 (f) is the only subsection of Section 27 specifically referring to a distribution in liquidation. It provides:

> "*Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid."

Section 27 (h), upon which the Commissioner once greatly relied and still does somewhat rely, provides:

[3] Section 27 (b), (c), (d), (e) and (g) need not be considered here since they are concerned, respectively, with dividend carryovers, dividends in kind, dividends in obligations of the corporation, taxable stock dividends, and preferential dividends.

> "*Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

To determine whether respondent is entitled to the dividends paid credit herein questioned, we must examine first the meaning of Section 27 (f) and then determine whether this distribution in liquidation is within the meaning of that Section. Once we establish that this distribution comes within the plain meaning of Section 27 (f), all the complicated arguments of the Commissioner, based upon other sections of the Act, must give way, as must his regulations.

B. Significance of the Language of Section 27 (f)

In the absence of a further statutory provision, a distribution in liquidation would not have qualified as a "dividend paid" within the meaning of Section 27 (a). *Hellmich* v. *Hellman*, 276 U. S. 233. In order, therefore, for a distribution in liquidation to qualify as a dividends paid credit, it was necessary for Congress to make specific provision for it in the Act. This was done in Section 27 (f).

The vital part of Section 27 (f), therefore, in so far as it concerns us here[4] is that

> "* * * amounts distributed in liquidation * * * shall, for the purposes of computing the dividends

[4] For the present we shall assume that the distribution in question is "properly chargeable to the earnings or profits accumulated after February 28, 1913". This question will be taken up separately (p. 11, *infra*).

paid credit under this section, *be treated as a taxable dividend paid*". (Italics supplied)

Similarly, Section 27 (h) provides:

"If any part of a distribution * * * is not a taxable dividend * * * no dividends paid credit shall be allowed with respect to such part".

Section 27 (f) thus provides that a liquidating distribution is to be treated not only as a dividend paid, but also as a *taxable* dividend paid, in computing the dividends paid credit to which the distributor is entitled. Thus, Congress, by Section 27 (f), required that a distribution in liquidation be *treated*: (1) as a "dividend" to overcome the difficulties in the *Hellmich* case; (2) as a "dividend paid" in order to qualify under Section 27 (a); and (3) as a "taxable dividend paid" to meet any requirements imposed by Section 27 (h). In direct and positive language, Congress said that a distribution in liquidation of earnings shall "be treated as", that is, shall be considered a "taxable dividend paid" irrespective of whether it *actually* be such or not.

The requirement of Section 27 (f) that amounts to be treated as a taxable dividend paid must be in fact "distributed in liquidation" is met by the stipulation of the parties that Credit Alliance "distributed to its stockholders, out of earned surplus cash and property of the value of $950,734.80". In law, the word "distributed" as used in the stipulation and as used in Section 27 (f) must mean what it has always meant in the Revenue Acts, namely, a transfer of something. For example, the transfer of the property by Credit Alliance in the instant case was a "distribution" within the meaning of Section 112 (b) (6) of the Revenue

Act of 1936. Certainly Congress should not be considered as having used the word "distributed" as meaning one thing in Section 27 (f) and something quite different in other sections of the same Revenue Act.

By making this distribution in liquidation a taxable dividend paid "for the purposes of computing the dividends paid credit under this section", it is stated in as blunt and simple language as is possible that every other subsection of Section 27 must be read in the light of the governing Section 27 (f).

Section 27 (f) qualifies the distribution as a "taxable dividend paid" under Section 27 (a). The requirement of Section 27 (h) that the dividend be taxable to the recipient, if applicable, is likewise completely met. Under Section 27 (f) the distribution must be "treated as a *taxable* dividend paid." We emphasize the word "*taxable*" which the Commissioner has continuously attempted to disregard. The Board of Tax Appeals and the Circuit Court of Appeals for the Fourth Circuit, as well as for the Second Circuit, have all recognized that Congress would not have provided in Section 27 (f) that a distribution should be *treated* as a "taxable dividend paid" and mean by such language that a distribution so treated would not meet the requirement of being a taxable dividend paid. As the Court said in the *Kay Manufacturing* case, *supra*, to do so would have deprived Section 27 (f) of all utility.

The whole argument of the Commissioner in this case is an attempt to delete the word "taxable" from the statute. Specifically, he attempts, by regulation, to deny the dividends paid credit upon the assumption that he has the power to erase from Section 27 (f) the word "taxable". If the Commissioner had such power, we would not be here. He disregards the unequivocal

command of Section 27 (f) that precisely this kind of distribution must be "treated" as if it were taxable, and taxable in the hands of the recipient since it could not be taxable anywhere else. No matter how tortuous his argument, the Commissioner cannot escape the demand of Section 27 (f) that this distribution be treated as "taxable" for all "purposes of computing the dividends paid credit".

We return now to the only remaining requirement of Section 27 (f), namely, that the distribution be "properly chargeable" to the earnings or profits accumulated after February 28, 1913. We submit that this statutory language must also be given its plain meaning, as was done by the Board and the Circuit Court of Appeals in this case, and by the Second Circuit in the *Kay Manufacturing* case.[5] As the Board and these Courts held, this language means, as it has always meant in the tax laws, that a distribution is properly chargeable to earnings or profits when it consists of earnings or profits and not of capital. Hence, our inquiry is whether in fact the $950,734.80 was distributed out of earnings or out of capital.

Inquiry ends in the stipulation, which states that out of a total distribution by Credit Alliance of $4,648,030.80, part ($3,697,302.00) was a distribution of capital and the remainder ($950,734.80) was a distribution of "cash and property" which was "distributed * * * out of earned surplus" which "represented, in its entirety, earnings and profits accumulated since February 28, 1913" (R. 11-12). In other words, the distribution

[5] Not only have these Courts rejected the Commissioner's interpretation of "properly chargeable", but no Court has ever accepted it. The Fifth Circuit in the *Centennial Oil* case decided for the Commissioner on the different ground that Section 27 (h) denied the credit.

of $950,734.80 was not out of capital but was chargeable solely to earnings or profits. Result: A dividends paid credit as claimed by this respondent.

That the words "properly chargeable to" were used by Congress in their normal and usual tax meaning, as we contend, is established by the Report of the Subcommittee of the Committee on Ways and Means on this very Section (74th Cong., 2nd Sess., March 26, 1936, p. 6) which said:

> "In computing undistributed net income, it is recommended that the corporation be allowed a deduction for any part of liquidating dividends properly allocable to earnings and profits, but no deduction shall be given for the portion thereof properly chargeable to capital account".

We do not see how the Commissioner can escape from the fact that Congress specifically set up as the test of chargeability the determination whether in fact the distribution came from earnings or from capital. If from the former, Congress intended that the dividends paid credit should be given; if from the latter, Congress intended that it should be denied. In this case the $950,734.80 was stipulated to be the former—thus determining the exact dividends paid credit to which this respondent is entitled.

Had the stock of Credit Alliance been owned entirely by individuals or had it been possible to liquidate the company in such manner as to avoid the application of Section 112 (b)(6), there is no doubt but that the Commissioner would have agreed that the stipulated figure as to earnings and profits distributed constituted "the part of such distribution which is *properly chargeable* to the earnings or profits accumulated after February

28, 1913". He would then obviously have taken the stipulated figure and allowed the dividends paid credit to that extent. And, yet, there is nothing in the Revenue Act of 1936 which indicates that the words "properly chargeable to" take on a different and varying meaning dependent on the taxable or non-taxable status of the recipient stockholders.

The reason why Congress inserted the words "properly chargeable to earnings and profits accumulated after February 28, 1913" in Section 27 (f) is readily apparent. "Dividends" alone, or contracts restricting their payment, were the only escape from the surtax on undistributed profits. Section 115 (a) provides that "dividends" are payable only out of "earnings or profits". Therefore, a distribution could only constitute a "dividend" to the extent there are "earnings and profits". This was particularly important in the case of liquidation distributions which ordinarily would involve substantial distributions of capital. To the extent of capital distributions Congress did not intend to permit a dividends paid credit. The proper charging of distributions to earnings or to capital was also of particular importance in the case of liquidations occurring over a period of more than one year since then it was necessary to ascertain the amount of earnings or profits available for distribution, or distributed, in subsequent years.

The words "properly chargeable to" are by no means new to the Revenue Act and they have been used in the past in comparable liquidation provisions to mean what they mean in Section 27 (f). We use the words, and rely upon them, to mean precisely what Congress has time and again said that they mean in the taxing statutes, while the Commissioner must rely

upon his own novel and unapproved interpretation of their meaning.

When the words "properly chargeable" first came into the revenue laws, Congress used them to distinguish a distribution of capital from a distribution of earnings. For example, in the partial liquidation provision of Section 201 (c) of the Revenue Act of 1924, it is stated that the part of an amount distributed in liquidation "which is properly chargeable to capital account" shall not be considered a distribution of earnings for the purpose of determining the taxability of subsequent distributions by the corporation.

The reports on Section 201 (c) of the Revenue Act of 1924, of both the House Ways and Means Committee (68th Cong., 1st Sess. H. Rept. 179, pp. 11-12) and the Senate Finance Committee (68th Cong., 1st Sess. S. Rept. 398, pp. 11-12) state as follows:

> "It is provided in the last sentence of section 201 (c) of the proposed bill that amounts distributed in partial liquidation of a corporation shall not, to the extent that they are properly chargeable to capital account, be treated as distributions of earnings and profits for the purpose of determining the taxability of subsequent distributions by the corporation. No similar provision is contained in the existing law, although the provisions of the bill represent what is probably the correct construction of the existing law and unquestionably what is in accord with business practice."

Section 115 (c), Revenue Act of 1936, covering distributions in liquidation, contains substantially the same language as Section 201 (c), Revenue Act of 1924, namely, that "the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits".

The words "properly chargeable to" as used in Section 201 (c), Revenue Act of 1924, and similar provisions of subsequent Revenue Acts, including Section 27 (f) of the 1936 Act, clearly require a division of the distributions into earnings and capital—not some intricate theory which would make the amounts "properly chargeable to" dependent upon whether the distribution was in whole or in part tax free to the stockholders.

Once it is shown that the distribution is out of earnings or profits and not out of capital, it is properly chargeable to earnings, and the mandate of Section 27 (f) is that then the distribution shall be *treated as taxable*. The Commissioner, on the other hand, insists that notwithstanding the fact that the distribution is from earnings as distinguished from capital, it cannot be properly chargeable to earnings unless the distribution is taxable to the recipient. By this illogical reasoning, he eliminates completely the necessity for the word "taxable" in Section 27 (f). It should be obvious from the language of the subsection that the requirement of "properly chargeable" produces the effect of the distribution being "treated as taxable", and that actual taxability of the distribution is not a prerequisite of making it "properly chargeable". The Commissioner's construction flies squarely in the face of the cardinal rule of statutory construction that significance and effect shall, if possible, be accorded to every word of a statute. *Market Co.* v. *Hoffman*, 101 U. S. 112, 115; *United States* v. *Standard Brewery, Inc.*, 251 U. S. 210, 218.

The Board of Tax Appeals, in considering the meaning of the term "properly chargeable" in this case, held that the phrase must be given its usual significance to indicate that which is distributed out of earnings as

contra-distinguished from that which is distributed out of capital. For example, in Section 115 (g) of the Revenue Act of 1936 the phrase "represents a distribution of earnings or profits accumulated after February 28, 1913" appears. That subsection deals with distributions in redemption of stock, and there can be no question, as the Board pointed out, that a distinction between capital and profits was intended. Again, in Section 113 (b) (1), dealing with the adjusted basis for the determination of gain or loss, it is provided that adjustments shall be made "for expenditures, receipts, losses, or other items, properly chargeable to capital account". The term "properly chargeable to capital account", as in all other cases, was used to distinguish from items *properly chargeable* to income or earnings.

The construction and meaning placed upon the term by respondent is also squarely supported by the Circuit Court of Appeals, Second Circuit, in the case of *Commissioner v. Kay Manufacturing Corp.*,[6] where the Court, in construing Section 27 (f) of the Revenue Act of 1936, said:

> "When it speaks of part of such distribution as being 'properly chargeable' to accumulated earnings, we agree with the Board that the term was used in its ordinary meaning to distinguish between capital and earnings and without reference to whether the earnings would be taxable in the hands of the distributee."

We rely on the plain and usual tax meaning of the statutory words and submit that it is entirely unnecessary to impute to those words an extraordinary and hidden meaning as contended for by the Commissioner. The language of Section 27 (f) is plain and the Con-

[6] 122 F. (2d) 443, 445.

gressional intent is clear. It squarely covers $950,734.80 of the $4,648,036.80 distribution made by Credit Alliance to its stockholders on December 10, 1936.

II

The Commissioner's Argument and Regulations Find No Support in the 1936 Act.

We have gone to some length to point out that the credit in this case is specifically authorized and required by Section 27 (f). As the question has been argued in several lower courts, the Commissioner has attempted to avoid the command of Section 27 (f) on first one ground and then another.[7] Always, the Commis-

[7] The Commissioner argued before the first appellate court to pass upon the precise problem here, that Section 27 (h) is an exception to, and controls, Section 27 (f). A majority of the Circuit Court of Appeals for the Fifth Circuit so held. (*Centennial Oil Co.* v. *Thomas*, 109 F. (2d) 359). Judge Hutcheson dissented in an exhaustive opinion pointing out that the plain language of 27 (f) requires the allowance of the credit and Section 27 (h) does not take it away. He did not think that the Commissioner had any authority to amend the Revenue Act by a regulation denying the credit Congress has allowed.

When the instant case came before the Board of Tax Appeals, the Commissioner relied heavily upon the theory which had prevailed before the Fifth Circuit, but the Board held that 27 (f), and not 27 (h), controlled. The Commissioner also argued that the distribution was not properly chargeable to earnings and profits because Section 115 (h) of the 1938 Act provided that a distribution in liquidation of securities or property other than securities, including money, to a parent was not a distribution of earnings. The Board rejected the notion that the 1938 Act could have any bearing in this case.

On appeal to the Fourth Circuit, the Commissioner largely abandoned his reliance on Section 27 (h) and stressed the contention that there was no distribution properly chargeable to earnings. The Commissioner's complicated and "tortuous" argument was rejected by the court. Shortly thereafter, the same question was determined against the Commissioner by the Circuit Court of Appeals for the Second Circuit in *Commissioner of Internal Revenue* v. *Kay Mfg. Corp.*, 122 F. (2d)

sioner's argument has involved the striking out from Section 27 (f) of the word "taxable" so that under any one of the Commissioner's different arguments Section 27 (f) has been, to use the words of the Second Circuit, deprived of its "utility".[8]

The Commissioner now takes the position before this Court that the plain words of Section 27 (f) cannot be given effect here because the Commissioner dictated differently in his Regulations. We will admit that if the Commissioner can delete what Congress has legislated, then the Regulations, and not the statute, must control this case. However, since the Commissioner has no such power, we will consider, as we turn to his contentions, his claim that the Regulation finds support either in Section 115 (h) of the 1936 Act or Section 27 (h) of that Act. We will then have reached the nub of the Commissioner's case, namely, that the Regulation should in any event control.

A. Neither Section 115 (h) nor Section 27 (h) Takes Away the Credit Allowed by Section 27 (f).

1. Section 115 (h) has no bearing here. Despite the plain language of 27 (f), the Commissioner argues that the words "properly chargeable" have a hidden and complicated meaning. It is not surprising that the Commissioner advances a complicated argument in an attempt to justify his complicated interpretation of the statute. We understand his argument to be the following:

> (a) A transfer in a tax-free reorganization under Section 112 has been held not to diminish the earnings and profits transferred, nor to render them a part of the transferee's capital account. Instead, the earnings and profits of the distributor remain earnings and profits in the hands of the dis-

[8] 122 F. (2d), at 445.

tributee, available for distribution as dividends which are taxable as income upon receipt by the distributee's stockholders. *Commissioner* v. *Sansome*.[9]

(b) Section 115 (h) of the Revenue Act of 1936 adopted the *Sansome* rule in the case of a distribution of securities but the principle is alike applicable to distributions of money and property, even though Section 115 (h) spoke only of stock or securities.

(c) Proof that Congress meant to include money and property in Section 115 (h) of the 1936 Revenue Act is shown by the fact that Congress amended Section 115 (h) in the 1938 Act specifically to include money in addition to stock and securities. The Committee Reports accompanying the 1936 and 1938 Acts, so the Commissioner says, show that Congress was only applying the general *Sansome* rule.

Each time the Commissioner has put this three-step argument to a court, the argument has been wholly rejected. The reasons are not difficult to find, and we will attempt to state them briefly.

(a) The *Sansome* case stands for the principle that earnings and profits of a predecessor corporation on a tax-free reorganization remained earnings and profits of the successor corporation after the reorganization. Of course, the *Sansome* situation is different from the situation here. In the *Sansome* case the transfer of the assets to the new company would have resulted in a gain to the *transferor* company except for the reorganization provisions of the Revenue Act. Gain or loss to the transferor on the transfer was accordingly postponed. On the other hand, the instant case involved a mere distribution of assets in kind in liquidation and could never have resulted in gain or loss to

[9] *Commissioner* v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2) and other cases cited by the Commissioner in his brief at p. 19.

the transferor, Credit Alliance. The Commissioner's Regulations have always so held.[10] Furthermore, in the *Sansome* case, the stockholders of the old company retained an interest in its earnings and profits through stock which they received in the new company. In the instant case, we do not have a reorganization, but have instead a complete liquidation. Accordingly, the assets in which the earnings and profits of respondent were invested were distributed directly to the stockholders, including the parent company, in liquidation of the stock which it held in respondent. The Commissioner's brief (fn. 11, p. 25) refers to Section 501, Revenue Act of 1940, as indicating the conviction of Congress that the *Sansome* principle has long pervaded the Revenue Acts. But the Senate Committee Report on this Section (Report No. 2114, 76th Cong., 3rd Sess., p. 25) is a strong indication that Congress never considered the rule applicable unless gain or loss of the transferor was postponed. The report states in part as follows:

> "Under various provisions of the Internal Revenue Code dealing with exchanges and liquidations, the transfer of the property by a corporation to another corporation results in the nonrecognition, in whole or in part, of the gain or loss *realized by the transferor* upon such transfer. In such cases well established principles of income tax law require that the earnings and profits of the transferor shall go over to the transferee and shall be considered to be earnings and profits of the transferee for tax purposes. These principles are to be given full effect under Section 501." (Italics supplied)

Since Credit Alliance could not *realize* any gain or loss upon its liquidation and it was therefore unnecessary

[10] Article 22(a)-21 of Regulations 94 and similar provisions of prior regulations.

to rely upon the "non recognition" provisions of the Internal Revenue Code, it follows that the instant case is not one of "such cases" covered by the *Sansome* case and the "well established principles of income tax law".

Furthermore, we do not need to consider here the possible application of the *Sansome* case to future dividends declared by Commercial Credit. It makes no difference whatsoever when we consider the position of the distributor for purposes of the undistributed profits tax, whether profits remain intact in the hands of the distributee or have become capital account in its hands. We are dealing here with a tax imposed upon the distributor and we are unconcerned with the question decided in the *Sansome* case of the tax to be imposed upon a shareholder of the distributee.

The *Sansome* case was decided by the Second Circuit as was the *Kay* case. That Court exploded the fallacy of the Commissioner's argument that its own earlier *Sansome* decision had any application. The Court said:

> "Section 27 (f) deals with liquidation distributions from the standpoint of the liquidating corporation rather than the distributee."[11]

The Commissioner says that necessarily the *Sansome* case must have "also decided" that the liquidation did not result in a distribution of earnings, for otherwise those earnings would not have remained intact. (Commissioner's brief, pp. 17-18) No authority is cited for this extraordinary assumption and to us it seems to be a complete *non sequitur*. The Court did not decide whether there was a distribution or not; it did not find itself facing any such problem. The Court in that

[11] *Commissioner of Internal Revenue* v. *Kay Mfg. Corp.*, 122 F. (2d) 443, at 445 (C. C. A. 2, 1941).

case was looking at the situation from the standpoint of the distributee. It held that there had been a transfer, but that the assets did not change from earnings into capital by virtue of the reorganization.

(b) The second step of the Commissioner's argument is that Congress partially embodied the doctrine of the *Sansome* case into Section 115 (h) of the 1936 Act, but meant to give its approval to the *Sansome* doctrine as a whole. (Commissioner's brief, p. 19) Section 115 (h) of the 1936 Act provided that a distribution of "stock or securities" is not a "distribution" of earnings or profits if no gain to the distributee is recognized on the distribution. Section 115 (h) has no conceivable bearing here because the distribution in the instant case was of money and property and was not of "stock and securities". That was stipulated (R. 3).

The Commissioner says that this Section is applicable because it shows a Congressional acceptance of the doctrine of the *Sansome* case. For the reasons we have already stated, the *Sansome* decision has no bearing on this case, and so it is immaterial that the irrelevant Section 115 (h) is declaratory of the irrelevant *Sansome* doctrine. The Senate Finance Committee Report,[12] which relates to Section 115 (h) of the 1936 Act, says specifically that the result of the *Sansome* doctrine is that stockholders of the distributee must pay a tax when the earnings of the distributor are distributed by the distributee. Nothing in that Committee Report (which is only partially quoted in the Commissioner's brief at p. 20) supports a theory that either the *Sansome* case or Section 115 (h) has any application to the tax status of a distributor of money and property other than securities.

[12] S. Rept. 2156, 74th Cong., 2nd Sess., *Seidman, Legislative History of Federal Income Tax Laws*, p. 251.

Even if Section 115 (h) of the 1936 Act could be viewed as affecting a distributor in a *Sansome* situation, that very fact would destroy the Commissioner's argument in this case. For, if Congress specifically legislated in Section 115 (h) that a distribution of stock or securities was not a distribution of earnings, then under ordinary canons of statutory interpretation a distribution of money and property other than stocks and securities would be a distribution of earnings and profits provided it was out of earned surplus.

(c) The Commissioner has attempted to supply the vital defects of the first two steps of his argument by pointing to the Amendment to Section 115 (h) in the Revenue Act of 1938 to include "money or property" within the *Sansome* rule. The Revenue Act of 1938 was enacted two years after the distribution in liquidation herein questioned. And we do not understand that the Commissioner contends that Congress was making the amendment retroactive. As the Commissioner points out in his brief, Section 115 (h) as amended is applicable retroactively to affect 1938 taxes, but this of course does not mean that the amendment affects taxes due under or imposed by the Revenue Act of 1936.[13]

The Commissioner attempts to use the Senate Committee Report accompanying the 1938 Act to prove the rule was the same in 1936 as it would be under the amendment in 1938. It is clear from a reading of the quoted portion of the Committee Report (Commissioner's brief, p. 24)[14] that the Committee had reference to

[13] When Section 115 (h) in the 1938 Act includes distribution before January 1938, it of course means only that for purposes of 1938 distributions, the earlier distributions shall not be considered distributions of earnings or profits.

[14] S. Rept. 1567, 75th Cong., 3rd Sess., pp. 18-19; *Seidman, Legislative History of Federal Income Tax Laws*, p. 64.

tax consequences of a distribution to its stockholders of the property received by the distributee or the tax consequences of *subsequent* distributions by the distributee or the distributor, and nothing more. We repeat that the Second Circuit did not overrule its earlier decision in the *Sansome* case when it said that the *Sansome* principle was not applicable to this case, nor did the Senate Committee, in the portion of its Report quoted by the Commissioner, give any indication that it thought that the *Sansome* rule would be applicable to Section 27 (f) of the Revenue Act of 1936.[15]

2. Section 27 (h) has no bearing here. Section 27 (f) provides that the distribution in this case "shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid". The Commissioner, however, argues (Commissioner's brief, pp. 31-34) that the quoted portion of Section 27 (f) is not applicable in this case because of Section 27 (h), which provides:

> "*Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

[15] If the liquidation and distribution in the instant case had occurred in 1938, we would be faced with the question whether Section 27 (g) of the 1938 Act (which is the same as Section 27 (f) of the 1936 Act) should be controlled and narrowed by the provisions of Section 115 (h) of the 1938 Act. If Section 115 (h) of the 1938 Act would control in such a case, it would not be because of the *Sansome* doctrine but because the statute covered more than the *Sansome* distributee situation. We do not see the relevance of discussing that question in this case. (Compare Commissioner's brief, p. 22; fn. 9.) As the court below pointed out:

> "Whether the same result would be reached under Section 115 (h) of the Act of 1938, which adds tax-free distributions of 'property or money' to the category of transactions not to be considered as distributions of earnings or profits, we have no occasion now to consider." (122 F. (2d), at 365)

As we have shown,[16] and as both the court below and the Second Circuit in the *Kay* case held, Congress did not take away in Section 27 (h) what it allowed in Section 27 (f). If meaning is to be given to the words used by Congress, then 27 (f) requires that this certain type of liquidation distribution shall be treated, for purposes of computing the dividends paid credit, as if it were a taxable dividend. The Commissioner concedes that 27 (f) requires that the distribution be treated as if it were a dividend, but his whole argument is based upon the deletion of the word "taxable" from the statute. The argument is faulty because it presupposes that Congress was unable to write one section without including contradictory subsections. If Section 27 (f) does not require a distribution in liquidation to be treated as "taxable" within the meaning of Section 27 (h), how can it be said that it requires it to be treated as a "dividend" within the meaning of that same Section 27 (h). As the Board put it, "the same phrase which provides treatment of the distribution as a dividend requires treatment as taxable dividend."[17] The result would be that no kind of a liquidation, whether or not under Section 112 (b) (6), would result in a dividends paid credit, and Section 27 (f) would be deprived of meaning. For, as we have shown, if a distribution in liquidation is not taxable, within the meaning of (f), on the same premises it is not *a* dividend, and since it is not a dividend it can never be a taxable dividend within the meaning of (h).

If there were any inconsistency between Section 27 (f) and (h), then (f), specifically dealing with distributions in liquidation, would control the more general (h), which includes all kinds of distribution not in liqui-

[16] *Supra*, pp. 9-10.

[17] 42 B. T. A., at 1025.

dation.[18] Section 27 (h) applies to any distribution which is not in the nature of a liquidating dividend of the kind specified in (f). As is specifically stated, Section 27 (h) applies to stock dividends covered by Section 27 (e) which might not be held to be income to the distributee within the meaning of the Sixteenth Amendment.[19] It applies to distributions contemplated by Section 115 (d) of the Act, which are not in partial or complete liquidation. It applies to distributions out of earnings and profits accumulated prior to 1913. It applies to dividends paid by corporations in one year and not taxable to the recipient until the succeeding year.[20]

To summarize our position, in the words of the Second Circuit in the *Kay* case (122 F. (2d) 443, 445):

> "Having made this specific provision in favor of the liquidating corporation it would be strange indeed if Congress intended to withdraw by paragraph (h) the benefit just granted by paragraph (f). As already shown, a distribution in liquidation of accumulated earnings is never 'a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title'; hence to read those words in paragraph (h) as modifying the language of paragraph (f) would deprive the latter of all utility. In our opinion the Board and the Fourth Circuit rightly refused to do so in the Credit Alliance case."

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[18] *United States* v. *Chase*, 135 U. S. 255, 260. See, in accord, the recent decision by Judge Schwellenbach in *Bracks, et al., Trustees* v. *Hendricksen*, —— F. Supp —— (U. S. D. C., W. D. Wash., Feb. 14, 1942, C. C. H. Fed. Tax Service, par. 9322).

[19] The fact that Section 27 (h) specifically includes the kind of distribution provided for in Section 27 (e) but does not specifically refer to liquidating distributions provided for in Section 27 (f) confirms our position.

[20] *Avery* v. *Commissioner*, 292 U. S. 210; *Commissioner* v. *Adams*, 54 F. (2d) 228 (C. C. A. 1).

B. Article 27 (f)-1 of the Regulations is an unreasonable and unauthorized attempt to amend Section 27 (f)

1. The Regulation ignores the plain meaning of Section 27 (f). The Commissioner places particular stress upon Article 27 (f)-1 of the Regulations, which states that the dividends paid credit provided for in Section 27 (f) will not be allowed in the case of a tax-free distribution within the meaning of Section 112 (b)(6). Up to this point in the brief, we have not made particular reference to the Regulations because we have been engaged in showing that Section 27 (f) stands on its own feet and is not affected by other sections or subsections of the Revenue Act of 1936. It requires in plain and unmistakable language that a distribution in liquidation which in fact represents earnings rather than capital shall be treated as if an ordinary dividend, taxable upon receipt by shareholders, had been paid.

If, as we contend, Section 27 (f) was intended to mean and did mean something which is plain and intelligible, then there is no room for a regulation which is based upon the theory that Section 27 (f) is a confused and equivocal statutory provision. There is no principle of law which authorizes an amendment to the meaning of a statute by Treasury Regulations. This Court has held many times that where "the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation." *Koshland* v. *Helvering,* 298 U. S. 441, 447; *Neuberger* v. *Commissioner of Internal Revenue,* 311 U. S. 83; see also *M. E. Blatt Co.* v. *United States,* 305 U. S. 267, 279; *Manhattan General Equipment Co.* v. *Commissioner,* 297 U. S. 129, 134.

The Commissioner argues that the Regulations received Congressional approval in the Revenue Act of 1938. Evidence of that approval is stated to be the amendment of Section 115 (h) in the 1938 Act to include distributions of money and property where before it had covered only distributions of stock or securities. This is the reverse of Congressional approval. If Congress had thought that the Regulations correctly interpreted its meaning expressed in the 1936 Act, there of course would have been no necessity for an amendment in the 1938 Act.[21] The fact that "property or money" was included in Section 115 (h) of the 1938 Act, which might or might not[22] be relevant in the case of a 1938 liquidation, is the best kind of evidence that Section 115 (h) of the 1936 Act did not apply to distributions of property or money in liquidation. Since it did not apply to such a distribution, there is no room for change by the Regulations.

> "In so far as Article 27 (f) of Treasury Regulations 94 purports to establish a rule contrary to the construction of the section we have approved, we

[21] The cases cited by the Commissioner in his brief, at p. 26, in support of his contention that there was Congressional ratification are all wide the mark. A good example is *White* v. *Winchester Country Club*, No. 63 this Term, decided January 12, 1942. In that case, Congress had used in a statute the equivocal words "dues or membership fees". The Commissioner, by administrative ruling, held that the payment for certain club privileges came within this statutory classification. In a later Act, Congress made the terms more definitive and this Court thereafter held that as a matter of initial statutory construction the Commissioner was correct, and that the amplification (as distinguished from change) by Congress in the later Act could be viewed as an approval of the Commissioner's ruling. That seems to us to be the reverse of the situation we have in the instant case. The Commissioner has not been defining the meaning of the word "taxable" in 27.(f). Instead, he has attempted to strike it right out of the statute. None of the cases he cites warrants this kind of administrative repeal.

[22] See p. 24, fn. 15, *supra*.

agree with the Fourth Circuit that it is unauthorized."[23]

Quite apart from this, as we have pointed out, (see fn. 2, p. 5, *supra*) the undistributed profits surtax was completely abandoned in 1938.

2. The Regulation is contrary to the purpose of Section 27 (f). The gist of the Commissioner's contention that the Regulations should control seems to be that if the credit is allowed in this case, the purpose of the undistributed profits tax will have been circumvented. That was a question for the judgment of Congress and not the Commissioner. But it is well to point out that Section 27 (f) fulfills the intention of Congress to encourage the simplification of corporate structures and is not contrary to the theory of the undistributed profits tax.

President Roosevelt, in a message to Congress in 1935, urged that the simplification of complicated corporate structures should be encouraged by revisions of the tax laws.[24] Accordingly, Congress in 1935 enacted two statutes encouraging simplification of corporate structures. On the positive side, Section 110 (a) of the Revenue Act of 1935 granted a tax benefit to those who would liquidate unnecessary subsidiaries by permitting them for the first time to do so without recognition of gain or loss. (Appendix A, p. 38, *infra*.) On the negative side, Section 102 (h) of the Revenue Act of 1935 placed a tax burden upon unnecessary corporate chains by imposing for the first time an inter-corporate dividend tax.

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[23] *Commissioner of Internal Revenue* v. *Kay Mfg. Co.*; 122 F. (2d) 443, at 445.

[24] "We should seek through taxation the simplification of our corporate structures through the elimination of unnecessary holding companies in all lines of business." (Message of the President, June 19, 1935, H. R. Rept. No. 1681, 74th Cong., 1st Sess., p. 4.)

When the Revenue Act of 1936 was enacted, both of these features of the 1935 Act were retained and other inducements to simplification were added. Section 110 (a) of the Revenue Act of 1935 was revised, broadened and re-enacted as Section 112 (b) (6) of the 1936 Act. Senator George, for the Senate Finance Committee, stated on the Floor of the Senate (80 Cong. Rec. 8799):

> "Section 112 (b) (6) of the present law was adopted last year by the Senate, as an amendment to the revenue bill of 1935. It was intended to permit the simplification of our corporate structures and the liquidation of subsidiaries."

Similarly, in the House, Representative Doughton, speaking for the Ways and Means Committee, explained (80 Cong. Rec. 10270):

> "Certain changes have been made in respect to the provision governing the liquidation of corporations which should facilitate the simplification of corporate structures."

There can be no question but that Section 112 (b) (6) was intended to encourage corporate simplification by removing the only deterrent then existing to liquidation of unnecessary subsidiaries—the recognition of gain to the *distributee* corporation.

At the same session at which liquidation was thus further encouraged, however, Congress was considering a new potential deterrent to liquidations—an undistributed profits tax upon the *distributor* corporation. Congress was determined that the potential threat should not be realized, and so Section 27 (f) was placed in the undistributed profits tax Act. The section covers the liquidation of unnecessary subsidiaries and any other kind of a liquidation, granting in each case a "taxable dividend paid" credit. In this respect, therefore, Sec-

tion 112 (b) (6) and Section 27 (f) are mutually complementary; both were deemed necessary by Congress to the fulfillment of its announced plan for the simplification of corporate structures through liquidation.

The Board of Tax Appeals in the instant case recognized the foregoing underlying purpose of Section 27 (f) when it said:

> "We think it obvious that Congress had in mind both the idea of forcing the payment of tax upon corporate earnings *and of encouraging liquidations of corporations forming parts of corporate chains.*"[25] (Italics supplied.)

The Circuit Court of Appeals likewise pointed out that the decision in respondent's favor

> "gives effect to the *coordinate purpose* of the Act manifested in this section and also in Section 112 (b) (6) to encourage the simplification of corporate structures by liquidation."[26] (Italics supplied.)

Finally, the Second Circuit in the *Kay* case said:

> "It should not be overlooked that the Revenue Act of 1936 was intended not only to raise revenue *but also to encourage the simplification of corporate structures.*"[27] (Italics supplied.)

This does not mean that Section 27 (f) grants any exemption to a liquidating corporation which it would not enjoy if it did not liquidate. The purpose is rather to avoid penalizing a corporation that is liquidating. It is clear that under 27 (a) a going concern is entitled to a dividends paid credit for a distribution to its par-

[25] 42 B. T. A. 1020, 1022.
[26] 122 F. (2d) 361, 365.
[27] 122 F. (2d) 443, 445.

ent. There is a like distribution in the case of a liquidation and accordingly there is no reason why a dividends paid credit should be denied in the latter case. The Commissioner objects because the *distributee* does not pay an undistributed profits tax on the sum received. Section 27 (f) has nothing to do with that for it is the mandate of Section 112 (b)(6) which controls. The Congressional history is clear that Congress did not intend to restrict the application of Section 112 (b)(6) and the Regulations are totally unauthorized in attempting to place such a restriction under the guise of an amendment to the plain meaning of Section 27 (f).

It is important to note that the clear Congressional purpose was adequately safeguarded from circumvention. Section 102 of the Act imposes a surtax upon corporations improperly accumulating surplus through the medium of permitting earnings or profits to accumulate instead of being divided or distributed. This means that if the distributee in later years makes profits which it does not need, because of the assets it already has (which include the sums received from respondent), it must distribute that portion of its later earnings that it does not need or pay a heavy penalty tax under Section 102. Furthermore, Section 27 (f) is applicable only to a *bona fide* liquidation, as the liquidation of Credit Alliance admittedly was. Any attempt to create a subsidiary for the purpose of avoiding the undistributed profits tax through the guise of a liquidation can and should be met with the argument provided by *Gregory* v. *Helvering*, 293 U. S. 465, and related cases, and not by distorting the plain words of the statute and penalizing *bona fide* liquidations.

It should suffice for purposes of this case to show that the Commissioner really is attacking Section 112 (b)(6) by an attempt to amend Section 27 (f), but the effect of the Regulations would be to place such a penalty upon *bona fide* liquidations that it is impossible to think that the Commissioner interprets the Congressional purpose. In this particular case, for example, Credit Alliance could not have liquidated at all without paying almost twice the taxes that would have been imposed had it not liquidated and had declared dividends out of these earnings.

Credit Alliance would have received a dividends paid credit if it had not liquidated but had distributed its earnings by way of an ordinary dividend. Had it done so, it clearly would have paid no undistributed profits tax. The parent distributee would have paid an undistributed profits tax, assuming, as was the case here, that the parent did not distribute any of the money and property received, of $62,521.24 and an increase in normal income tax of $13,424.10. The computations by which these amounts are determined from the record are set out in Appendix B to this brief, p. 53, *infra*. Credit Alliance did not make distribution by way of an ordinary dividend; but instead, to simplify the corporate structure, the parent liquidated Credit Alliance pursuant to Section 112 (b)(6).[28] Because this was done, even though the Commissioner must concede that Congress wanted this kind of thing done, the Commissioner now claims that an undistributed profits tax of $121,814.49 is owing.

We are not complaining because the Commissioner is attempting to assess a higher tax than we would have

[28] Since it owned over 80% of all the stock of Credit Alliance, it would have been difficult for the parent to take the liquidation without the scope of Section 112 (b) (6).

been required to pay if we had liquidated in some other way. We complain because the Commissioner is asserting an unauthorized penalty against liquidations. It is, therefore, no answer to say (see Commissioner's brief, pp. 29-30) that we could have avoided the tax by refusing to liquidate, or that the parent company could have refused to distribute its own earnings (see Commissioner's brief, p. 29, fn. 16) which would of course be contrary to the obvious purpose of the Act.

Nor is it any answer to say that Credit Alliance could have distributed these earnings as a dividend and could thereafter have liquidated because the Commissioner takes the position that the dividend is part and parcel of the liquidation, and the Board of Tax Appeals has so held.[29] On the theory that the Commissioner advances in this case, a corporation which ought to be liquidated is in a dilemma. It is subject to the heavy liquidating tax whether it distributes earnings in liquidation or distributes earnings and then liquidates. Congress imposed no such dilemma, for it specifically refused in Section 27 (f) to assess a penalizing tax upon a joinder of the acts of distribution and liquidation. On this point, the legislative history is conclusive.[30]

The only answer that the Commissioner makes to this extraordinary disregard of the Congressional purpose is to say that Article 27 (f)-1 (c) of the Regulations creates a method by which the transferee corporation

[29] Cf. *The Biltmore Co.*, B. T. A. Memo. decision (Docket No. 100709, C. C. H. Dec. 11, 361-G.); *Holmby Corp.* v. *Commissioner*, 83 F. (2d) 548 (C. C. A. 9); *Canal-Commercial Trust & Savings Bank* v. *Commissioner*, 63 F. (2d) 619 (C. C. A. 5); *Gossett* v. *Commissioner*, 59 F. (2d) 365 (C. C. A. 4).

[30] Senator La Follette, in discussing the Conference Report on the Floor of the Senate, pointed out to the Senate that the liquidation provisions were placed in the Revenue Act of 1936 "to enable corporations with complicated corporate structures to liquidate and not to pay excessive penalties in the process". (80 Cong. Rec. 10469)

may, subject to approval by the Commissioner, apportion and allocate to the transferor corporation any dividends paid credit allowed the transferee corporation for dividends paid to its shareholders during the portion of the taxable year subsequent to its receipt of the distribution from the distributor. In other words, says the Commissioner, if the parent corporation had declared a dividend to its shareholders immediately after receipt of the distribution from Credit Alliance on December 10, 1936, it might have, if the Commissioner had permitted it, donated so much of the resulting dividends paid credit as it wished to Credit Alliance, keeping the rest for itself.

We think argument is unnecessary to show that nowhere in the Revenue Act of 1936 or in its Congressional history is there any authorization for the Commissioner to embark on this complex scheme. Indeed, the Commissioner has argued before the Board in this case that the validity of this portion of the Regulations was not involved and the Board so held.[31] Even now, the Commissioner says that Credit Alliance cannot object to the extraordinary scheme because it is intended to aid Credit Alliance. But if the Commissioner wants to rely on this portion of the Regulations to justify his attempt to amend Section 27 (f), the validity and authorization of Article 27 (f)-1 (c) is certainly subject to question. If, as we think is plain, Article 27 (f)-1 (c) is invalid, then the rest of the Commissioner's interpretation of 27 (f) falls with it. As the court below said:

> "The government also refers, without avail to Article 27 (f) of Treasury Regulations 94, which, without legislative sanction, authorizes a distributee in liquidation to allocate or transfer a dividends paid credit earned by it under the Act to its dis-

[31] 42 B. T. A., at 1029.

tributor. Indeed this regulation serves to indicate that the Treasury's interpretation of Section 27 (f) imposes so unreasonable a burden on the distributor in liquidation that some affirmative action to alleviate the consequences, at least in part, was required."[32]

Finally, the Commissioner says that 27 (f) allows an "exemption from tax" and that the principle announced by this Court in *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, is applicable (Commissioner's brief, pp. 35-36). This is not an exemption as that term is used by this Court. In the *Northwest Steel Mills* case, the corporation attempted to obtain credit under Section 26 (c) of the Act, although it did not distribute or transfer anything. This Court, of course, said that Section 26 (c), which in certain cases gives a special credit even though there has been no transfer of any monies at all, should be strictly construed. Admittedly, respondent in this case distributed everything it had and Section 27 (f) grants no exemption of any kind but merely directs that the distribution constitutes a dividends paid credit. Indeed, the whole purpose of Section 27 is to deduct the income that is distributed in order to determine the undistributed remainder of income upon which the tax is imposed.

CONCLUSION

The Commissioner would have us think that the Revenue Act of 1936 was so confused that it was necessary for a Regulation to legislate "novel provisions to be woven into interrelated sections of unusual complexity so as to achieve harmonious administration".[33]

There is nothing complex or involved in our position, which is that Congress used simple and intelligible lan-

[32] 122 F. (2d), at 366.

[33] Commissioner's brief, pp. 12-13.

guage in Section 27 (f) of the 1936 Act. Because its meaning and purpose is plain, no weight should be given to the Regulations which attempt to amend Section 27 (f) out of existence.[34] We rely upon a strict construction of the statute, for we have in mind the teaching of this Court that:

> "* * * the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover." (*Lynch v. Alworth-Stephens Co.*, 267 U. S., at 370.)

The decision of the Circuit Court of Appeals was correct and should be affirmed.

Respectfully submitted,

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March 30, 1942.

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[34] "Under different circumstances great weight has been attached to administrative practice and Treasury rulings, but beyond question they cannot narrow the scope of a statute when Congress plainly has intended otherwise." (*Neuberger v. Commissioner of Internal Revenue*, 311 U. S. 83 (1940)).

APPENDIX A

Pertinent Provisions of Statutes and Regulations

1. *REVENUE ACT OF 1935*

Sec. 102. Income Taxes on Corporations.

* * * * *

(h) Section 23(p) of the Revenue Act of 1934 (relating to the deduction of dividends received by corporations) is amended by striking out the words "the amount" and inserting in lieu thereof the following: "90 per centum of the amount."

Sec. 110. Corporate Liquidations.

(a) Section 112(b) of the Revenue Act of 1934 is amended by adding after paragraph (5) a new paragraph reading as follows:

"(6) *Exchange in Liquidation.*—No gain or loss shall be recognized upon the receipt by a corporation of property (other than money) distributed in complete liquidation of another corporation, if the corporation receiving such property on such exchange was on the date of the enactment of the Revenue Act of 1935 and has continued to be at all times until the exchange, in control of such other corporation. As used in this paragraph 'complete liquidation' includes any one of a series of distributions by a corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding five years from the close of the taxable year during which is made the first of the series of distributions under the plan. If such transfer of property is not completed within the taxable year the Commissioner may require of the taxpayer, as a condition to the non-recognition of gain under this paragraph, such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure the assessment and collection of the tax if the transfer of the property is not completed in accordance with the plan. This paragraph shall not apply to any liquidation if any distribution in pursuance thereof has been made before the date of the enactment of the Revenue Act of 1935."

2. REVENUE ACT OF 1936

Sec. 13. Normal Tax on Corporations.

* * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation, a normal tax as follows:

Upon normal-tax net incomes not in excess of $2,000, 8 per centum.

$160 upon normal-tax net incomes of $2,000; and upon normal-tax net incomes in excess of $2,000 and not in excess of $15,000, 11 per centum in addition of such excess.

$1,590 upon normal-tax net incomes of $15,000; and upon normal-tax net incomes in excess of $15,000 and not in excess of $40,000, 13 per centum in addition of such excess.

$4,840 upon normal-tax net incomes of $40,000; and upon normal-tax net incomes in excess of $40,000, 15 per centum in addition of such excess.

(c) *Exempt Corporations.*—For corporations exempt from taxation under this title, see section 101.

(d) *Banks and Trust Companies.*—For rate of tax on certain banks and trust companies, see section 104.

Sec. 14. Surtax on Undistributed Profits.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26(a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount allowed as a credit under section 26(d).

(D) In the case of a national mortgage association created under Title III of the National Housing Act, the amount allowed as a credit under section 26(e).

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends

paid credit provided in section 27 and the credit provided in section 26(c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

17 per centum of the portion of the undistributed net income which is in excess of 20 per centum and not in excess of 40 per centum of the adjusted net income.

22 per centum of the portion of the undistributed net income which is in excess of 40 per centum and not in excess of 60 per centum of the adjusted net income.

27 per centum of the portion of the undistributed net income which is in excess of 60 per centum of the adjusted net income.

Sec. 26. Credits of Corporations.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax:

* * * *

(b) *Dividends Received.*—85 per centum of the amount received as dividends from a domestic corporation which is subject to taxation under this title. The credit allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

Sec. 27. Corporation Credit for Dividends Paid.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

(b) *Dividend Carry-Over.*—In computing the dividends paid credit for any taxable year, if the dividends paid during the taxable year are less than the adjusted net income, there shall be allowed as part of the dividends paid credit, and in the following order:

(1) Dividends paid during the second preceding taxable year in excess of the adjusted net income for such year, to the extent not needed as a dividends paid credit for the taxable year preceding the taxable year the tax for which is being computed; and

(2) Dividends paid during the first preceding taxable year in excess of the adjusted net income for such year.

No credit shall be allowed for dividends paid by a corporation prior to its first taxable year under this title.

(c) *Dividends in Kind.*—If a dividend is paid in property other than money (including stock of the corporation if held by the corporation as an investment) the dividends paid credit with respect thereto shall be the adjusted basis of the property in the hands of the corporation at the time of the payment, or the fair market value of the property at the time of the payment, whichever is the lower.

(d) *Dividends in Obligations of the Corporation.*—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value is lower than the face value, then when the obligation is redeemed by the corporation, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

(e) *Taxable Stock Dividends.*—In case of a stock dividend or stock right which is a taxable dividend in the hands of shareholders under section 115(f), the dividends paid

credit with respect thereto shall be the fair market value of the stock or the stock right at the time of the payment.

(f) *Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

(g) *Preferential Dividends.*—No dividends paid credit shall be allowed with respect to any distribution unless the distribution is pro rata, equal in amount, and with no preference to any share of stock as compared with other shares of the same class.

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

Sec. 112. Recognition of Gain or Loss.

* * * *

(b) *Exchanges Solely in Kind.*—

(6) Property Received by Corporation on Complete Liquidation of Another.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except non-voting stock which is limited and preferred as to

dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the stockholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not com-

pleted within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer.

Sec. 115. Distributions by Corporations.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have

been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117(a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

(d) *Other Distributions from Capital.*—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

(e) *Distributions by Personal Service Corporations.*—Any distribution made by a corporation, which was classified as a personal service corporation under the provisions

of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921, shall be exempt from tax to the distributees.

(f) *Stock Dividends.*—

(1) General Rule.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) Election of shareholders as to medium of payment.—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means as distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

3. REVENUE ACT OF 1938

Sec. 115. Distributions by Corporations.

* * * *

(h) *Effect on earnings and profits of distributions of stock.*—The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or be-

because exempt to him under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

4. REGULATIONS 94

Art. 27(f)-1. Dividends paid credit for distributions in liquidation.

(a) *Distributions which diminish earnings or profits.*— To the general rule that the dividends paid credit is allowable only with respect to taxable dividends paid, section 27(f) makes one exception, namely, for that part of an amount distributed in liquidation which, under the Act, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. Thus, a distribution either in complete or partial liquidation of a corporation is treated by the Act as one constituting in part a distribution of, and being properly chargeable to, earnings or profits, if—

(1) Under the provisions of section 115(c), the amounts distributed in liquidation are treated as received in payment in exchange for the stock; and

(2) Under the provisions of section 112, the gain or loss, if any, from such exchange is recognized.

In such a case, a dividends paid credit is allowable for the amount actually involved in such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to the gain or loss realized and recognized upon an exchange, rather than that employed with respect to a taxable dividend.

On the other hand, certain transactions described in sections 112 and 115 are treated, for the purposes of the Act, not as distributions to the shareholders of earnings or profits, but as transfers of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Act as earnings or profits derived from

its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Act. No dividends paid credit is allowable with respect to such transactions.

(b) *Amount properly chargeable to earnings or profits.*— In the case of a distribution in liquidation with respect to which a dividends paid credit is allowable (see paragraph (a) of this article) the amount of the credit is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913. The application of this paragraph may be illustrated by the following example:

Example: The Y Corporation was organized on January 1, 1910, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. The preferred stock was to receive annual dividends of $7 per share and $100 per share on complete liquidation of the corporation in priority to any payments on common stock, and was to participate equally with the common stock in either instance after the common stock had received a similar amount. However, the preferred stock was redeemable in whole or in part at the option of the board of directors at any time at $106 per share plus its proportion of the earnings of the company at the time of such redemption. In 1910 the preferred stock was issued at $106 per share, for a total of $106,000, and the common stock was issued, at $100 per share, for a total of $200,000. On July 15, 1936, the company had a paid-in

surplus of $6,000, consisting of the premium received on the preferred stock, earnings or profits of $30,000 accumulated prior to March 1, 1913, and earnings or profits accumulated since February 28, 1913, of $75,000. On July 15, 1936, the option with respect to the preferred stock was exercised and the entire amount of such stock was redeemed at $141 per share or a total of $141,000 in a transaction upon which gain or loss to the distributees resulting from the exchange was determined and recognized under the Act, such transaction being only a partial liquidation under section 115(c). The amount of the distribution allocable to capital account was $116,000 ($100,000 attributable to par value, $6,000 attributable to paid-in surplus, and $10,000 attributable to earnings or profits accumulated prior to March 1, 1913). The remainder, $25,000 ($141,000, the amount of the distribution, less $116,000, the amount allocable to capital account) is properly chargeable to the earnings or profits accumulated since February 28, 1913, and is allowable as a dividends paid credit.

(c) *Credit in respect of earnings or profits transferred under certain tax-free transactions.*—If, as a result of one or more transactions described in section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year, shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year subsequent to the consummation of such tax-free transaction may, subject to the provisions of section 115, be apportioned and allocated to the transferor as a distribution out of such earnings or profits of the transferor. The resolution of the board of directors of the transferee shall specifically designate the distribution, or part thereof, so apportioned and allocated. For the purposes of the dividends paid credit, any such distribution so allocated shall be treated as a dividend paid only in the computation of the credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding taxable years. Each corporation shall file as a part of its return for the taxable year involved, (1) a statement setting forth concisely all of the material facts, including the date and the character of the transaction under section 112, the status at that time of the earnings or profits of both

corporations, the date and amount of all dividend distributions subsequently made, and the particular distribution or portion thereof designated as effecting a distribution of the earnings or profits of the transferor corporation; and (2) a certified copy of the resolution of the board of directors of the transferee corporation with respect to the distribution. No dividends paid credit based upon such apportionment and allocation will be allowed unless the Commissioner is satisfied that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of this paragraph. The provisions of this paragraph may be illustrated by the following example:

Example: The P Corporation, which keeps its books and makes its income tax returns on the basis of a fiscal year ending March 31, owned all of the capital stock of the S Corporation. The S Corporation, which keeps its books and makes its returns on the calendar year basis, was completely liquidated on December 1, 1936. At that time, the S Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $50,000, in addition to earnings or profits for 1936 of $20,000, and an adjusted net income of $45,000. It had paid no dividends prior to its liquidation. The P Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $60,000 in addition to earnings or profits of the taxable year computed as of the end of the year in the amount of $80,000, and an adjusted net income in the amount of $60,000. The P Corporation pays dividends as follows: June 15, 1936, $25,000; September 15, 1936, $25,000; December 15, 1936, $25,000; and March 15, 1937, $25,000. No portion of the dividends paid on June 15 and September 15 prior to the liquidation and no portion of the dividend paid on March 15, 1937, after the close of the taxable year of the S Corporation may be allocated to the S Corporation. The dividend paid on December 15 may, by appropriate corporate action, be made as one effecting a distribution out of the current earnings or profits of the S Corporation to the extent of $20,000. No part of that distribution may be allocated to the S Corporation's accumulated earnings or profits since, under section 115 (b), the earnings or profits of the P Corporation and the S Corporation for the taxable year ($100,000) are sufficient in amount to cover all the distributions made during that year ($100,000).

Art. 27(h)-1. Nontaxable distributions.—No dividends paid credit shall be allowed with respect to any part of the distribution by a corporation to its shareholders which is—

(a) not out of earnings or profits of the taxable year or out of earnings or profits of the corporation accumulated subsequent to February 28, 1913 (see section 115), or, in the case of distributions in liquidation, not properly chargeable to earnings or profits of the corporation accumulated after February 28, 1913, under article 27(f)-1;

(b) in the case of a corporation which was classified as a personal service corporation under the Revenue Act of 1918 or the Revenue Act of 1921, out of earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921 (see section 115(e)); or

(c) a distribution in stock of the corporation or rights to acquire its stock which does not constitute income to its shareholders within the meaning of the sixteenth amendment to the Constitution (see section 115(f) and articles 115-3 and 115-4).

The effect of subsections (g) and (h) of section 27 is that no dividends paid credit is allowed with respect to any distribution unless each of the shareholders of that class, who are subject to taxation under Title I for the period in which the distribution is made, receives a taxable dividend as a result of the distribution.

The application of section 27(h) may be illustrated by the following examples:

Example (1): A, B, C, and D are the shareholders of the Y Corporation, which makes its returns on the calendar year basis, D being an educational corporation exempt from income tax under section 101. On July 15, 1936, the Y Corporation paid a dividend (within the meaning of section 115) in cash of $1,000. A and B make their returns on the calendar year basis, but C makes his return on the basis of the fiscal year ending July 31. The Y Corporation is entitled to a dividends paid credit in the amount of $1,000 with respect to the dividends paid on July 15.

Example (2): If the facts in the preceding example are the same, except that A and B make their returns on the basis of the fiscal year ending July 31, the Y Corporation is entitled to a dividends paid credit in the amount of $1,000 with respect to the dividends paid on July 15.

APPENDIX B

COMPUTATION OF UNDISTRIBUTED PROFITS TAX IF ALL OF ADJUSTED NET INCOME OF CREDIT ALLIANCE CORPORATION HAD BEEN DISTRIBUTED IN 1936 AS AN ORDINARY DIVIDEND

I. CREDIT ALLIANCE CORPORATION

If all of the adjusted net income had been distributed as a dividend there would obviously have been no undistributed profits tax due from the Credit Alliance Corporation.

(1) Net income (per 90-day letter, R. 7)	$	703,147.25
(2) Normal tax (per 90-day letter, R. 7)		104,312.09
(3) Adjusted net income (per 90-day letter, item (1) less item (2), *supra*)	$	598,835.16
(4) Amount which would have been distributed to all shareholders as ordinary dividend		598,835.16
(5) Undistributed net income (item (3) less item (4), *supra*)	$	0.00
(6) Undistributed profits tax	$	0.00

II. COMMERCIAL CREDIT COMPANY

If all of the adjusted net income of Credit Alliance Corporation had been distributed as a dividend, Commercial Credit Company as the owner of 526,238 out of 528,186 shares would have received $596,626.54, upon which it would have paid an additional undistributed profits tax of $62,521.24.

(7) Net income (per return, R. 40)	$11,812,303.10
(8) Additional income which would have been received as ordinary dividend from Credit Alliance Company $\left\{\frac{526,238}{528,186}\right.$ of item (4), *supra*)	596,626.54
(9) Total net income (item (7) plus item (8), *supra*)	$12,408,929.64
(10) Normal tax paid (per return, R. 40)	$ 1,019,748.48
(11) Intercorporate dividend tax (15% of 15% of item (8), *supra*)	13,424.10
(12) Total normal tax (item (10) plus item (11))	$ 1,033,170.58
(13) Adjusted net income (item (9) less item (12), *supra*)	$11,375,759.06
(14) Dividends paid (per return, R. 40)	9,804,241.77
(15) Undistributed net income (item (13) less item (14))	$ 1,571,517.29

Computation of undistributed profits surtax (sec. 14 (b)):

(16) 10% of adjusted net income (10% of item (13))	$ 1,137,575.91
(17) Balance of undistributed net income (item (15) less item (16))	433,941.38
(18) Surtax of 7% on item (16)	79,630.31
(19) Surtax of 12% on item (17)	52,072.97
(20) Total undistributed profits surtax (item (18) plus item (19))	$ 131,703.28
(21) Undistributed profits surtax paid (per return)	69,182.04
(22) Additional undistributed profits surtax (item (20) less item (21))	$ 62,521.24

SUPREME COURT OF THE UNITED STATES.

No. 708.—October Term, 1941.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Credit Alliance Corporation.	On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[April 27, 1942.]

Mr. Justice Roberts delivered the opinion of the Court.

The Commercial Credit Company, a Delaware corporation, acquired and owned over 99% of the capital stock of the respondent, a New York corporation actively engaged in business. In 1936 the respondent's stockholders and directors resolved to liquidate the corporation and to make distribution to its stockholders in liquidation. Part of the distribution so made in 1936 was of cash and property constituting surplus earned after February 28, 1913, of the value of $950,734. Of this Commercial Credit Company's share was $947,228. Further distributions were made in 1937 and final distribution in 1938, and the corporation was legally dissolved. The liquidation complied with the provisions of §112(b)(6) of the Revenue Act of 1936,[1] under which no gain or loss for tax purposes was attributable to Commercial Credit Company as a result of the distribution. That corporation did not, in 1936, distribute to its stockholders any of the distribution received by it from the respondent and did not apportion or allocate any part thereof to the respondent.

The question is, to what dividends paid credit is the respondent entitled under the applicable sections of the Revenue Act of 1936.[2]

By § 14 there was imposed for the first time a tax upon "undistributed net income". In order to compute the base for this levy the dividends paid credit is to be deducted from adjusted net income.

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[1] 49 Stat. 1648, 1679.

[2] §§ 14, 27, and 112. 49 Stat. 1648, 1655, 1665, 1678.

Section 27 deals with the credit for dividends paid. Subsection (a) provides that, for the purposes of Title I of the Act, the dividends paid credit shall be the amount of dividends paid during the taxable year. Each of the additional subsections deals with a separate topic relating to the computation and allowance of the credit. The only ones here of importance are (f) and (h):

"(f) *Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid."

"(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

The taxpayer insists that the distribution in question is governed by the provisions of (f). The Government asserts that it is not, for these reasons: that the phrase "which is properly chargeable to the earnings or profits accumulated after February 28, 1913" takes the distribution out of the purview of the section; that (h) denies the benefit of (f) to the taxpayer if the money or property transferred is not taxable to the distributee; that the policy of the Act, and the purpose underlying provisions other than § 27, require that (f) be not construed as permitting the credit where the distribution gives rise to no tax upon the distributee, and that an applicable regulation precludes the credit.

The Government's second contention has been sustained by the Circuit Court of Appeals for the Fifth Circuit,[3] but both the first and the second have been overruled by the Circuit Court of Appeals for the Second Circuit,[4] and by the Board of Tax Appeals and the court below in the instant case.[5] In view of the conflict we granted certiorari.

1. Although a distribution in liquidation of earnings which accrued subsequently to February 28, 1913, does not constitute a

[3] Centennial Oil Co. *v.* Thomas, 109 F. 2d 359; Hutcheson, J., dissenting.
[4] Commissioner *v.* Kay Mfg. Corp., 122 F. 2d 443.
[5] 42 B. T. A. 1020; 122 F. 2d 361.

dividend in the proper sense of the term,[6] subsection (f) categorically declares that a liquidating distribution, to the extent it is composed of such earnings, shall, for the purposes of computing the dividends paid credit "*be treated as a taxable dividend paid.*" Plainly the section intends that a distribution of such earnings shall be considered a dividend. Further it provides that the distributing corporation may use the amount in computing its credit for dividends paid. And, to put the matter beyond cavil, the section also says that the distribution shall be treated as the payment to the distributee of a *taxable* dividend.

The Government, however, contends that the clause "properly chargeable to the earnings or profits accumulated after February 28, 1913," means properly chargeable to the distributee as such earnings or profits. The argument has, we think, rightly been rejected by all the courts which have considered it. The line drawn in all of the revenue acts between profits accumulated before the enactment of the first income tax act and after that date for distinguishing capital and income furnishes the reason for the insertion of the clause in subsection (f). Section 27 deals with a credit to the distributing corporation and the phrase finds its proper office in limiting the amount of the distribution in liquidation which may be considered a dividend from earnings or profits as distinguished from one composed of capital. We, therefore, conclude that (f), standing alone, justifies the deduction claimed by the respondent.

2. It is urged that the sweeping provision of (h) precludes the application of (f) in the circumstances disclosed, because (h) denies the credit unless the amount distributed is taxable to the distributee. By concession the distribution here does not result in gain or loss to the parent company. The argument is in effect that (h) creates an exception to the rule formulated by (f).

As above said, each of the subsections of § 27 deals with a specific and particular topic. Subsection (f) deals with "distributions in liquidation" while subsection (h) deals with "nontaxable distributions". If (f) applies in this case, (h) is left to cover a substantial field of other sorts of distributions. We should, of course, read the two sections as consistent rather than conflicting, if that be possible. Here it is not only possible but begets no absurd or impractical result. We hold that (h) is not applicable to the facts of this case and that (f) is.

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[6] Hellmich v. Hellmann, 276 U. S. 233.

3. The petitioner points out that the Revenue Act of 1936 introduced a new policy,—to tax undistributed earnings in order to prevent a taxpayer from accumulating untaxed surplus by forcing the payment of dividends which become taxable in the hands of the distributee. This is true, but it is also true that the Act made distributions to parent corporations nontaxable in order to encourage the simplification of corporate structures. It was avowedly for this reason that § 112(b)(6) provided that no gain or loss to the parent company should in such case be recognized, and it may well be that subsection (f) of § 20 was inserted with the same purpose. The Government insists that as § 115(h)[7] provides that a distribution of the taxpayer's stock or securities, or those of another corporation, shall not be considered a distribution of earnings or profits of the taxpayer if no gain to the distributee from the receipt of such stock or securities is recognized by the law, subsection (f) must be read in the light of the policy thus declared by § 115(h). The latter section is irrelevant to this controversy because the distribution here was in property and money and not in stock or securities. Section 115(h) was amended in 1938 subsequent to the consummation of the transaction here in question to include money or property, but we cannot, as the Government suggests, read into the section, as it stood when the transaction took place, an intent derived from the policy disclosed by the subsequent amendment.

We shall not burden this opinion by extended reference to the legislative history of the Act of 1936. It is enough to say that it is inconclusive and, to some extent, supports the arguments of both parties. But whatever may be said of the policy behind the statute's provisions, we are not at liberty to disregard the direct and unambiguous language of subsection (f).

4. Treasury Regulations 94, Art. 27(f), declare that one making a liquidating distribution of earnings accumulated since February 28, 1913, must be denied the dividends credit in respect of such distribution unless the amount distributed is taxable in the same year to the distributee, but further provides that if the distributee, in that year, makes a distribution which entitles it to a dividends credit it may allocate a proper proportion thereof to the distributor of the liquidating dividend. It is insisted that the situation presented to the Treasury by the various provisions of the Revenue

[7] 49 Stat. 1688.

Act of 1936 was confused and complex and the adoption of the regulation was proper in the circumstances and should control.

In view of what we have said as to the plain meaning of subsection (f), we think that no complexity or confusion is discoverable and that the regulation not only was contradictory of the plain terms of the subsection but attempted to add a supplementary legislative provision, which could only have been enacted by Congress. We hold, therefore, that the court below was right in refusing to give effect to the regulation.

The judgment is affirmed.

The CHIEF JUSTICE took no part in the consideration or decision of this case.

Mr. Justice BLACK, Mr. Justice REED and Mr. Justice DOUGLAS dissent. They are of the opinion that since Art. 27(f) of Treasury Regulations 94 resolves the ambiguities between § 27(f) and § 27(h) of the Revenue Act of 1936 it is a valid interpretative regulation and a proper exercise of the rule-making authority.

A true copy.

Test:

Clerk, Supreme Court, U. S.